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Retail Vendor PERFORMANCE MANAGEMENT BULLETIN

A Look at Retail Inventory Performance in 2016

SCDigest recently conducted its annual analysis of inventory performance for 2016 across industry sectors, including many retail and consumer goods categories.

There are two key inventory measures: Days Inventory Outstanding (DIO), and the more familiar – to supply chain managers – the inventory "turns" metric. DIO is often used in the financial department because it can tie into measurement of changes in working capital and hence cash flow, when combined with Days Sales Outstanding and Days Payables Outstanding.

DIO is calculated as follows:

DIO = End of Year Inventory Level/[Total Cost of Goods Sold/365]

So, you calculate the average cost of goods sold for one day, and then see how many of those COGS days you keep in inventory (based on year-end balance sheet numbers).

As such, DIO is sort of the reverse of inventory turns, in that a higher DIO, all things being equal, means poorer inventory management performance, while a lower number signals improvement. You are being more efficient with inventory versus a given level of COGS.

Conversely, inventory turns is measured as follows:

Cost of Goods Solid/End of Year Inventory

Overall, US retailer inventories have been trending up in recent years. The US Commerce Dept. tracks the inventory-to-sales (ITS) ratio, which measures how much inventory companies hold versus one month of sales revenue. That ratio was 1.41 in August, versus 1.29 in August of 2011, an increase of 9.3% over those six years, though flat with 2016 numbers (retail inventory levels are of course also highly seasonal).

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Industry News Round Up

RPS Benchmark Report on Supply Chain Execution

The analysts at ***Retail Systems Research*** are out with their latest benchmark report on Supply Chain Execution.

Highlights of the research include:

- The effect Amazon has had on other retailers is profound. retail winners believe one of their best chances to compete is by using any stores they have in a more meaningful way – as both a way to fulfill orders and to process returns.
- When it comes to opportunities, retail winners look to add same-day delivery capabilities, and are open to adding more local distribution centers for forward-positioned inventory to help make that happen. Under-performers see the same opportunity, but from a very different perspective; they want to reduce inventory investments without impacting sales – an unrealistic goal, RSR says.
- Before building the business case for significant changes to the supply chain, most retailers want to address the issue of inventory visibility and accuracy. ROI is not relevant.
- The number of retailers that have achieved "a lot of visibility" has significantly improved even from the 2015 supply chain benchmark. RSR notes inventory visibility enables other supply chain improvements, and the best

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Compliance Networks Corner:

"BOPIS" to the Rescue - The Role of Visibility

By Richard Wilhjelm, Compliance Networks

As we outlined in last month's article, BOPIS (buy online pickup in store) is a strategic option for traditional brick and mortar retailers as a growing customer demographic demands immediate or same-day receipt of their purchases.

For some, overnight shipping charges are prohibitive and 2-day shipping just isn't quick enough. For the time-strapped consumer, the ability to secure their product online, march down to the store in an hour or two, go to customer service and pick up their product and quickly be on their way is an extremely attractive option.

The benefits for the retailer are numerous: selling existing stock without additional freight and minimal handling, creating additional cross sell opportunities, protecting and even reinforcing the retailer's brand, and mitigating margin risk are some that quickly come to mind. And, the consumer may be willing to pay a little (not a lot, but a little) more if they can get it today versus waiting. I know I am.

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A Look at Retail Inventory Performance in 2016 (continued)

What's more, retailers also have a higher ITS than do manufacturers or wholesalers. The August ITS, for example, was 1.32 for manufacturers and 1.20 for wholesalers, versus the 1.41 level for retail cited above.

With all that said, here are some inventory turn numbers for leading retail sectors (the numbers in parentheses denote how many retailers are in each category), in descending order of inventory turns in 2016:

- On-Line Retail (4): 59.2
- Convenience Stores: (3): 45.8
- Grocery (8): 13.8
- Drug Stores (3): 9.6
- Office Products (2): 7.4
- Electronics (2): 5.6
- Mass Merchants and Dept. Stores (12): 5.3
- Specialty Apparel (15): 4.9
- Dollar Stores (3): 4.8
- Home Improvement (3): 4.5
- Dept. Stores Only (7): 3.6
- Retail Footwear (4): 3.6
- Sporting Goods (3): 2.9
- Autoparts (4): 1.9

By way of comparison, apparel manufacturing had average turns of 3.5 in 2016, consumer packaged goods 6.2, food manufacturers 7.4, and consumer durables manufacturers 6.1.

"...retailers also have a higher ITS than do manufacturers or wholesalers. The August ITS, for example, was 1.32 for manufacturers and 1.20 for wholesalers, versus the 1.41 level for retail cited above."

Compliance Networks Corner: "BOPIS" To The Rescue (continued)

What is the impact of BOPIS on vendor performance and the overall supply chain? After numerous conversations with senior retail supply chain executives, as I laid forth in the previous article, to execute a BOPIS strategy key characteristics of the supply chain must include:

- Visibility
- Speed
- Execution
- Inventory Integrity

In this article, we will look closely at the visibility challenges a retailer must overcome to execute their BOPIS strategy.

"Where is my stuff?" is a common question heard from retail merchants. What exactly does visibility mean to the retail enterprise as it pertains to inventory? Is it granular visibility to the actual physical locations of inventory? Visibility into a vendor's ability to deliver on their on-time and fill rate promises? Or, is it in the retailer's ability to flow shipments to their stores once the product is received at a consolidator or distribution center?

I believe it's all three - and more. The importance of knowing the physical location of inventory is obvious, but visibility into the location of inbound product and on-time and fill-rate performance data is just as important. Let me give some examples.

How many times do our merchants change their purchase orders, creating an impossible moving target for their vendors that needlessly extends the purchase order lifecycle?

What is the vendor's ability to put in the carton what they said they put in the carton? This sounds simple, but results from the Auburn University 2011 ASN Accuracy study suggest otherwise. Look for the updated study at the November 2017 Retail Value Chain Federation conference.

How many days does it take from PO creation to store receipt of merchandise and how does that affect our buying decisions and capital outlays?

If I need to create an emergency order, what vendor has the best track record of consistent on-time and complete order fulfillment?

I will go out on a limb here and say visibility into the performance of all major stakeholders (merchants, vendors, supply chain) will become more important than the visibility of the physical item itself. Why? Because as the cost of information continues to decline, we move closer to the 1990's unifying objective of supply chain, which was to "trade inventory for information".

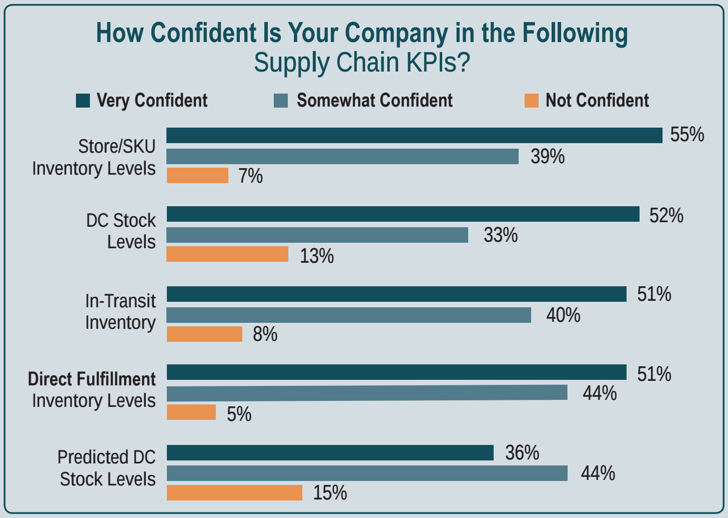
What does visibility have to do with BOPIS? Brand credibility for starters. If you invite your dearest friends over for dry-aged steak and Caymus, they are likely to be disappointed if you serve lasagna and Chianti Classico. Not that lasagna and Chianti aren't fine choices, but expectations are like a contract and when you don't meet or exceed them, you have broken them. So, before you invite the customer into your store to pick up their product, it's wise to be 100% sure the product is there. Visibility gives the retail enterprise the confidence that the merchandise will be there when the customer comes to pick it up.

As a long-time resident of southern Florida, my neighbors and I faced shortages of cash, fuel, and water in advance of Hurricane Irma. Much to my surprise and disappointment, guaranteed two-day delivery is apparently not a legally-binding term. With not a bottle of water to be found in the state of Florida, my wife was able to cleverly source and secure a case of water on-line at our local office-supply store. BOPIS to the rescue!

Industry News Round Up (continued)

performers are already using it as a competitive wedge to further separate themselves from average and under-performers.

However, even given that last point retailers don't have a high level of trust in their metrics. As seen in the chart on the right from the report, for example, only a little more than half of retailers have high levels of confidence in key supply chain related metrics such as inventory levels at the store and the DC. Only slightly more than one-third have a high level of confidence in predicted DC inventory levels.



Source: RSR Research, October 2017

cosmetics – which has inventory accuracy issues – is nevertheless challenged due to tag placement issues and difficulty reading many RFID tags in a small area.

Consistent reductions in tag and reader costs is helping ROI in more categories, Bracken said, adding that RFID ROI in retail can be challenging because it often depends on estimates of increases sales from more accurate inventory counts, especially when stores implement ecommerce efulfillment from stores.

There was surprisingly little focus on working with vendors in the report, but that said here are a few data points.

- 50% of retail "winners" have a high level of concern vendors will go direct to consumer faster than they can, versus just 15% of all other respondents.
- In terms of opportunities for improving supply chain execution, better collaboration with trading partners was well down the list, cited by about 20% of respondents as being in the top three. Adding more local distribution centers topped the list.

The full benchmark report is available for free at the RSR website with registration.

Straight Talk on RFID from Retail Panel

Since Walmart announced its ultimately failed RFID mandate back in 2003, it has generally been difficult to get straight talk about the technology and its adoption due to much hype from the RFID system vendor community – and in some cases adopters of the technology themselves,

So it was refreshing to see research firm the Platt Retail Institute conduct a very balanced interview with three retailers who were very realistic about RFID adoption, benefits and challenges.

Here are some highlights:

Karl Bracken, senior vice president, supply chain transformation, Target, said that while the company's goal is to eventually tag all SKUs and categories, the reality, Bracken said, is that for Target the RFID ROI is different across product categories, of which Target has many.

It is still difficult to read tags on say bottles of water and certain electronics products, Bracken said, while a category such as

Rene Saroukhanoff, senior director of global merchandise planning, reporting & analytics and Levi Strauss, noted that getting results in in-store pilots is much different than making that happen across hundreds of stores.

"There are impacts to business process. There's employee training. Any time you're touching store operations, it becomes a bit of a big deal," Saroukhanoff added.

Allan Smith, former CIO at retailer Lululemon, interestingly noted that the benefits from moving RFID further upstream from the store is more challenged than you might think.

"When we started establishing priorities, we found that what really causes the inaccuracy at the end of the day is the human touch points with product. In the store is where that happens the most. As you move up the supply chain, there are fewer touches to your individual products. It's more case and pallet level," Smith observed - meaning the ROI is harder to find.

It should be mentioned that any vendor RFID tagging program must be supported by a compliance management process in just the same way the bar code labeling has been monitored by many retailers for years. There are many ways there can be issues with vendor tagged merchandise, which often result in costly retagging at the DC or store. Compliance Networks is ready to work with retailers on vendor RFID compliance.

The Value of Reducing Vendor Variability

2017 may go down as the year retailers started to look seriously at reducing supply chain variability driven by vendor performance, with Walmart and Target both announcing major initiatives in this area.

More on this soon from the *Retail Vendor Performance Management Bulletin* – and of course vendor compliance is at the core of such programs.

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